

JOSEPH P. C. LEE & ASSOCIATES

In association with
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26 February 2014

The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sirs,

Consultation Paper on Amendments to the Code on Real Estate Investment Trusts
("Consultation Paper")

Following consultation amongst a number of market participants, whose names are set out in Schedule 1 of this response (this working group is together referred to in this response as the "Group"), the Group supports the SFC's initiative, as expressed in the Consultation Paper, to amend the REIT Code to allow for greater flexibility in the investment scope of REITs with respect to (a) investment in properties under development or engagement in property development activities and (b) investment in financial instruments.

In addition to the proposals set forth in the Consultation Paper, the Group also supports other initiatives proposed by the Financial Services Development Council in the FSDC Research Paper No. 04 (Developing Hong Kong as a Capital Formation Centre for Real Estate Investment Trusts) issued in November 2013 ("FSDC Report") which could further enhance the competitiveness of the Hong Kong REIT market.

The Group's comments are set out in response to the questions raised in the Consultation Paper and to support the other initiatives proposed herein and have been prepared in consultation amongst the members of the Group. Unless otherwise defined, capitalized terms used herein shall have the same meanings as those defined in the Consultation Paper.

Question 1: Do you consider that flexibility in respect of property development investments and related activities should be introduced for REITs?

The Group strongly agrees in principle that flexibility in respect of property development investments and related activities should be introduced for REITs. Such flexibility should

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enhance the competitiveness of the REIT market in Hong Kong as this is in line with other mature REIT markets.

Further, if REITs can invest early in a property development project cycle, they will no longer be restricted to a supply of completed product only, which is often limited in Hong Kong, and by investing at an early stage, REITs may be able to take advantage of a lower entry cost. Additionally, REITs will be able to redevelop aging or irrelevant assets in their portfolio to enhance their relevance to the REIT at a later date (i.e. long after the initial public offering), particularly in cases where the financial benefit of redevelopment outweighs the benefit of simply maintaining a property. Finally, the ability to develop sites will create another potential purchaser of greenfield sites, alongside developers, further increasing the price efficiency of this market.

However, the Group suggests that the SFC consider using a more specific definition of “property under development”. For instance, the term could be defined as property at any stage of development where an occupation permit or its equivalent has not yet been obtained from the relevant authorities. Such definition should be included for clarity, so that REIT managers and unitholders will have certainty as to what is, and is not, a permissible investment. The Group believes that a more specific definition of “property under development” is particularly important in light of Hong Kong Accounting Standard 40 (“HKAS 40”), which requires fair value accounting of balance sheet assets. In the context of HKAS 40, and in light of the 10% GAV Cap discussed below, greater specificity in the definition is critical. The Group also suggests that the valuation requirements of HKAS 40 may be referred to in the more specific definition.

The Group wishes the SFC to clarify whether the flexibility in respect of property development investments and related activities will accommodate “design-and-build” schemes for REITs. The Group supports the inclusion of “design-and-build” within permitted investment in property under development, as such schemes provide REITs with even greater control of their development activities, enabling them to invest in projects that are designed and built according to their specific needs and investment strategies.

The Group notes that this enhanced flexibility will mitigate the anomaly that overseas-listed REITs can acquire land and develop properties in Hong Kong, but Hong Kong-listed REITs currently cannot.

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Question 2: Do you consider that the 10% GAV Cap is set out as an appropriate threshold?

The Group agrees that 10 % GAV Cap is set as an appropriate threshold, in light of similar thresholds in place in other REIT markets.

Question 3: Do you have any comments on how the Property Development Costs should be calculated?

The Group agrees with the proposal on how Property Development Costs should be calculated. However, the Group believes that once a REIT obtains the requisite opinion from an independent expert, then the REIT manager's estimate of such cost should be presumed (rebuttably) to be a reasonable estimate.

The Group suggests that disclosure on development costs should be included as part of a REIT's regular bi-annual reporting requirement. However, the Group further suggests that, in the event of any substantial cost overrun (e.g. 10%), the REIT manager should issue an announcement to inform unitholders and should be required to take reasonable steps to mitigate the overrun.

In respect of note (1) to paragraph 7.2A of the proposed amendments to the REIT Code (the "**Proposed Amendments**"), it is stated that the "independent expert" shall be "acceptable" to the SFC. The Group suggests that the SFC incorporate paragraph 17 of the Consultation Paper into this note so that there will be a pre-determined standard in deciding what will be regarded as "acceptable" to the SFC. Alternatively, it will be helpful if the SFC maintains a list of acceptable independent experts for ease of reference. This will expedite the process without requiring a REIT to obtain the SFC's clearance.

The Group suggests removing note (2) to paragraph 7.2A of the Proposed Amendments. The "fair estimate" made by the REIT manager, plus the opinion of the independent expert referred to in note (1) to paragraph 7.2A of the proposed amendments should inevitably take into account a "prudent buffer" as referred to in note (2).

The Group suggests that the meaning of "material change in the overall risk profile of the scheme" referred to in note (4) to paragraph 7.2A of the Proposed Amendment be clarified. Given the REIT manager is in the best position to gauge this, the Group suggests that a

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“material change in the overall risk profile of the scheme” should be in the reasonable opinion of the REIT manager.

Regarding note (5) to paragraph 7.2A of the Proposed Amendments, the Group suggests that further clarification should be made to the meaning of “requisite resources”. The Group suggests that “requisite resources” should be either in-house skills or by way of outsourcing to a competent external party, which is set out in paragraph 24(d) of the Consultation Paper.

Question 4: Do you have any comments on the frequency of periodic updates that should be provided to unitholders on the status of property development investments and related activities?

The Group agrees in principle that REIT managers should provide periodic updates to investors about the status of property development investments and related activities. In respect of the proposed obligation to issue an announcement to inform unitholders upon the REIT entering into a contract for property development investment and related activities, the Group suggests that an announcement should only be required if a transaction the value of which exceeds 5% of the gross asset value of the scheme is entered into. This is to ensure that only material information will be disseminated to the unitholders by way of an announcement.

Question 5: What additional safeguards do you consider appropriate to ensure there will not be any material change to overall risk profile of a REIT despite the flexibility to engage in a limited extent of property development investments and related activities?

The Group suggests that the safeguards suggested in paragraph 24 of the Consultation Paper should be codified in the REIT Code so that additional obligations will be imposed on the REIT managers if the REIT chooses to undertake property development investments and related activities.

The Group also suggests that the limitations on borrowing as set out in paragraph 7.9 of the REIT Code should be revised such that a REIT’s borrowings may exceed 45% of the gross asset value of the REIT up to a maximum of 60% if a credit rating of the REIT is obtained from Fitch, Moody’s or Standard and Poor’s. The ability to increase gearing up to a maximum of 60% if a credit rating is obtained is in line with other mature REIT markets, including Singapore.

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Further, the Group suggests if a REIT's borrowings exceed 45% as a result of a depreciation in the asset value of the REIT, it will not constitute a breach for the purposes of paragraph 7.9 of the REIT Code. This is also in line with the Singapore REIT market.

Question 6: Do you have any comments on the proposed scope of the Relevant Investments and the proposed Maximum Cap?

The Group agrees in principle with the proposed scope of Relevant Investments and the proposed Maximum Cap.

The Group has queries regarding the Proposed Amendments set out in paragraph 7.2B(ii) which specify that the Relevant Investments should be sufficiently "liquid" and have "transparent pricing". The scope of Relevant Investments can include listed securities and unlisted debt securities. In the case of "unlisted debt securities", they may not be able to fulfill the requirements set out in paragraph 7.2B(ii). The Group suggests that paragraph 7.2B(ii) be clarified to avoid the seeming inconsistency.

Further, the Group would like the SFC to give more guidance on "internationally recognized stock exchanges" referred to in paragraph 7.2B(a) of the Proposed Amendments.

Regarding investments in "local or overseas property funds" (paragraph 7.2B(d) of the Proposed Amendments), the Group suggests where such investments constitute already-permissible REIT investments, they should be included within the general 75% of GAV category and not the Maximum Cap.

The Group also suggests that the investment restrictions and requirements with regard to Relevant Investments be applied at the time when the transactions are entered into, and not at any later time.

Question 7: What other safeguards do you consider appropriate to be put in place corresponding to the proposal to allow for the Relevant Investments?

The Group suggests that provisions be included in the Code to the effect that if the Maximum Cap is exceeded for whatever reason, the REIT manager may not take any action that will increase the extent of the breach and must take reasonable steps to mitigate the extent of the breach. However, the REIT manager should not be required to divest any

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assets that breach the restrictions or requirements if such breaches were as a result of events taking place after the acquisition of Relevant Investments, such as any depreciation of the value of the REIT's assets. If the REIT manager is required to divest assets under such circumstances, it could be to the detriment of the unitholders as it might be a "forced sale" situation resulting in a lower disposition price.

Further, the Group suggests that the safeguards set out in paragraphs 45 and 46 in the Consultation Paper should be codified.

Additional Proposals

The Group supports certain other initiatives proposed in the FSDC Report to further enhance the competitiveness of the Hong Kong REIT market. In particular,

- the Group believes that, due to the inherent tax disadvantages a Hong Kong REIT faces when compared to REITs organized in certain other markets, Hong Kong REITs should be exempted from profits tax on rental income;
- in order to increase financial competitiveness, REITs listed on The Stock Exchange of Hong Kong Limited should be exempted from stamp duty on transfers of non-residential property;
- similar to the standards governing corporations in Hong Kong (and without seeing any basis for distinguishing), the Group believes that REITs and REIT unitholders, as the case may be, should be subject to privatization by way of a general offer followed by a statutory compulsory acquisition, and to reliance on schemes of arrangement similar to those under the Companies Ordinance (Chapter 32 of the Laws of Hong Kong); and
- the Group suggests that Mandatory Provident Fund constituent funds should be able to invest in units of a REIT authorized by the SFC without reference to the current 10% investment limitation, as drawing a distinction between shares of a corporation and units of a REIT makes no sense for purposes of distinguishing between permissible and restricted investments.

The Group urges the SFC to contact and collaborate with the relevant authorities, including, without limitation, the Inland Revenue Department and the Mandatory Provident Fund Schemes Authority, to bring about the above changes.

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The Group is happy to discuss any part of this response with the SFC or answer any questions you may have. Whilst there has been a team of individuals with experience in the areas covered by the Consultation Paper working with the Group in preparing this response, in the first instance please feel free to contact

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Enclosures

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SCHEDULE 1

Members of the Group

CIMB Securities Limited
Citigroup Global Markets Asia Limited
Deutsche Bank AG, Hong Kong Branch
Goldman Sachs (Asia) L.L.C.
Merrill Lynch Far East Limited